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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1565

ASSOCIATED GAS DISTRIBUTORS,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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ASSOCIATED GAS DISTRIBUTORS

Member Companies

Atlanta Gas Light Company
The Brooklyn Union Gas Company
Central Hudson Gas and Electric Corporation
Consolidated Edison Company of New York, Inc.
Elizabethtown Gas Company
Fitchburg Gas and Electric Light Company
Long Island Lighting Company
New Jersey Natural Gas Company
New York State Electric & Gas Corporation
North Carolina Natural Gas Corporation
Philadelphia Electric Company
Philadelphia Gas Works
Piedmont Natural Gas Company, Inc.
Public Service Company of North Carolina, Inc.
Rochester Gas and Electric Corporation
UGI Corporation
Washington Gas Light Company

TABLE OF CONTENTS

	Page
TABLE OF CITATIONS	ii
OPINION BELOW	2
JURISDICTION	2
STATUTORY PROVISIONS INVOLVED	2
STATEMENT OF THE CASE	2
A. Proceedings Before The Federal Power Commission	3
1. The Two-Tier Producer Rate System and Opinion No. 639	3
2. The Instant Proceedings	5
B. Proceedings in the Court Below	6
REASONS FOR GRANTING THE WRIT	8
CONCLUSION	15

APPENDICES:

Appendix A	A-1
Appendix B	A-47
Appendix C	A-57

TABLE OF CITATIONS

	Page
Cases:	
Atlantic Refining Co. V. Public Service Comm'n., 360 U.S. 378 (1959)	12
Associated Gas Distributors v. FPC, No. 73-1793 (D.C. Cir. 1976)	*passim*
FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944)	12
Haggar v. Helvering, 308 U.S. 389 (1940) . . .	10
Ozawa v. U.S., 260 U.S. 178 (1922)	10
Shell Oil Co. v. FPC, 491 F.2d 82 (5th Cir. 1974)	5, 14
Federal Power Commission Proceedings:	
Area Rates for the Appalachian-Illinois Basin Areas, Opinion No. 639, 48 FPC 1299 (1972), *aff'd sub nom.* Shell Oil Co. v. FPC, 491 F.2d 82 (5th Cir. 1974)	*passim*
Order No. 411, 44 FPC 1112 (1970)	4
Other Southwest Area Rate Proceeding, 46 FPC 900, *aff'd sub nom.* In re Other Southwest Area Rate Cases (Shell Oil Co. v. FPC), 484 F.2d 469 (5th Cir. 1973), *cert. denied* 417 U.S. 973 (1974); Texas Gulf Coast Area Rate Proceeding, 45 FPC at 707-708	11
Panhandle Eastern Pipe Line Company, Opinion No. 626, 48 FPC 518 (1972) . . .	14
Permian Basin Area Rate Proceeding, 361 FPC 149 (1965), *aff'd sub nom.* Permian Basin Area Rate Cases (Continental Oil Co. v. FPC), 390 U.S. 747 (1968)	3, 8, 9, 10, 12

Tennessee Gas Pipeline Company, Opinion No. 667, 50 FPC 1194 (1973) 15

Texas Gulf Coast Area Rate Proceeding, 45 FPC 674, 713 (1971), *aff'd on remand sub nom.* Public Service Comm'n v. FPC, 516 F.2d 746 (D.C. Cir. 1975) . . . 10, 11

Southern Louisiana Area Rate Cases, 46 FPC 86 (1971), *aff'd sub nom.* Mobil Oil Corporation v. FPC, 417 U.S. 283 (1974) 14

Statutes:

28 U.S.C. §1254(1) 2

15 U.S.C. §717, *et seq.* 2

Codes:

18 CFR §§154.107 and 154.108 . . . . . 4, 9

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioner Associated Gas Distributors (AGD) respectfully prays that a writ of certiorari be issued to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit entered in this case on January 28, 1976.

OPINION BELOW

The opinion of the Court of Appeals has not yet been reported. It is attached hereto as Appendix A.

JURISDICTION

This Court's jurisdiction is invoked under 28 U.S.C. §1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. §717r(b).

STATUTORY PROVISIONS INVOLVED

The relevant portions of the Natural Gas Act, 15 U.S.C. §717, *et seq.*, are set out in Appendix C of this Petition.

STATEMENT OF THE CASE

This case involves judicial review of two F.P.C. rate increase orders[1] which are representative of a large class of rate increases authorized by the F.P.C. during the period from April 1973 to June 1974.[2] The rate orders at bar were sought and received by Mobil Oil Corporation (Mobil) and Continental Oil Company (Continental).

The purchasers of gas in these two sales are interstate pipeline companies[3] which sell gas at wholesale to gas distribution companies including members of the Associated Gas Distributors (AGD) group of Petitioners. AGD is an ad hoc group of natural gas distribution companies providing gas utility service to consumers in the major market centers of

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[1] These orders, together with related F.P.C. orders denying rehearing thereof, are included as Appendix B of this Petition.

[2] *See*, note 33, *infra*, and accompanying text.

[3] In the Continental sale, the purchaser is Tennessee Gas Pipe Line Company. In the Mobil sale, the purchaser is Texas Eastern Transmission Corp.

the eastern seaboard.[4] Individually, these companies are legally responsible for maintaining adequate natural gas utility service at reasonable rates within their respective franchise areas. As a result of the decision here on review, and F.P.C. action in a series of comparable orders affecting a large number of other interstate gas sales to pipelines serving AGD companies, the price of gas sold to AGD companies and, in turn, sold to their gas consumers, has been substantially increased. Likewise, these orders have failed to elicit any additional gas supply for AGD's consumers. Accordingly, AGD's interest here is that of protecting its consumers from any unlawful or unjustified increase in the cost of natural gas and their right to an adequate gas supply.

A. Proceedings Before the Federal Power Commission

1. The Two Tier Producer Rate System and Opinion No. 639.

Commencing with its landmark decision in the *Permian Basin Area Rate Cases*,[5] the F.P.C. had established by the close of 1971 a system of area ceiling price regulation for all jurisdictional sales of natural gas by producers in each of the gas production areas of the contiguous 48 states.[6] In each area, the scheme of rate design was determined on a basis of a full adjudicatory hearing or a rulemaking proceeding in which all interested parties had a full opportunity to file initial and reply comments on all matters under consideration by the F.P.C. A common element adopted by the F.P.C. in each of its area pricing orders was a two-tier rate structure. Thus, gas previously developed and dedicated to the interstate market (designated as "flowing gas") received one price while new gas

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[4]The members of AGD are listed on the inside cover of this Petition.

[5]*Permian Basin Area Rate Proceeding*, 34 FPC 159 (1965), *aff'd. sub nom. Permian Basin Area Rate Cases (Continental Oil Co. v. FPC)*, 390 U.S. 747 (1968).

[6]See cases cited at Appendix A, pp. 8-9 (Dissenting Opinion).

dedicated after the institution of the rate proceeding received a higher, incentive-oriented price. The purpose of this higher price was (a) to reflect the higher current and future exploration and development costs as contrasted with the lower costs extant when the flowing gas was dedicated, (b) to gear the incentive features in the new gas price to the relative need for gas, and (c) to encourage the dedication of new gas reserves to the interstate market.

On January 28, 1972, a number of pipelines and distributors filed a petition to initiate a fresh review of prices in the Appalachian and Illinois Basin areas. The petitioners requested a "third tier" price of 50 cents per Mcf for new gas reserves dedicated to the interstate market after February 1, 1972. The F.P.C. issued a notice summarizing this petition in F.P.C. Docket No. R-371 on June 19, 1972. The notice encouraged comments and the public was advised that the Commission would consider termination of the moratoria provisions applicable to that area and "such revisions of §154.107, 154.108... as may be found to be in the public interest."[7]

On December 12, 1972, the Commisison issued its Opinion No. 639[8] denying petitioners' request for the establishment of a third price ceiling. The F.P.C. then addressed the two-tier or rate vintaging feature of the area rate system—a subject not mentioned in the initial petitions, the F.P.C.'s notice, or any comments filed pursuant to that notice—and declared not only that vintaging should be eliminated in this area but in all production areas.[9] To this end, the Commission stated that its previous area rate orders

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[7]Rate ceilings were established in that area pursuant to Order No. 411, 44 FPC 1112 (1970). Sections 154.107 and 154.108 are codifications of the rate orders for the Appalachian-Illinois Basin areas, respectively, 18 CFR §§154.107 and 154.108. As in all prior area rate decisions, Order No. 411 contained a two-tier rate design.

[8]*Area Rates for the Appalachian-Illinois Basin Areas,* Opinion No. 639, Docket No. R-371, 48 FPC 1299(1972), *aff'd, sub nom. Shell Oil Co. v. FPC,* 491 F.2d(5th Cir. 1974).

[9]*Id* at 1309.

should be "literally and strictly applied," i.e., if a flowing gas contract expires by its terms, and a new contract is executed, sales under such contract will be governed by the ceiling price applicable to new or second vintage contracts. Thus, by way of dictum, the Commission purported in its Appalachian and Illinois Basin order to carve out a major exception to the two-tier scheme of price regulation governing all other producing areas. On appeal, this feature of Opinion No. 639 was upheld as a permissible interpretation of previous area rate orders.[10]

2. The Instant Proceedings

The present cases were initiated by separate F.P.C. filings by Mobil and Continental. On December 21, 1972, Mobil sought permission to abandon certain service to Shell Oil Company (Shell). The application stated that Mobil's contract with Shell had expired and that a new contract had been executed with Texas Eastern Transmission Corporation, the pipeline to which Shell had previously delivered the gas received under the now-expired Mobil-Shell contract. Approval of the Mobil-Texas Eastern sale was sought in a companion application; in that application, Mobil sought a rate equal to the 25 cents per Mcf area ceiling for "new" of second vintage gas established for the Texas Gulf Coast Area.[11] As authority for its collection of the higher, "new gas" ceiling rate, Mobil relied on F.P.C. Opinion No. 639.

The Continental filing was made on February 15, 1973. There, Continental submitted a "renewal contract," i.e., a gas sales agreement under which it agreed to continue service rendered to Tennessee Gas Pipeline Company under a contract which had expired by its terms. Continental's rate filing likewise sought permission to collect the higher, new gas rate

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[10] *Shell Oil Co. v. FPC*, 491 F.2d 82 (5th Cir. 1974).

[11] The record does not disclose the price previously collected by Mobil. However, the ceiling price for first vintage sales from this area was 19 cents per Mcf.

on the basis of Opinion No. 639.

AGD filed timely petitions to intervene in each of these proceedings. In due course, each of the producers' requests were granted and AGD filed applications for rehearing. AGD argued in these applications (a) the application of the new gas price to these sales was not justified by evidence in these cases nor by the dictum of Opinion No. 639, (b) that the two price system adopted throughout the Commission's area rate orders could not be undone without an evidentiary predicate, and (c) that the Commission's duty to protect the consumer requires that some assurance of a gas supply *quid pro quo* be obtained before rate increases are allowed for sales already dedicated to the interstate market. In its rehearing orders, the Commission cited Opinion No. 639 as dispositive of the producers' right to charge the new gas rate for the sales in question.[12] The Commission thus refused to undertake any independent review of the circumstances surrounding the instant sales to determine whether these rate increases were likely to yield any corresponding increase in gas supply.

B. Proceedings in the Court Below

On appeal, the Court of Appeals for the D.C. Circuit upheld the Commission's action in these cases in a 2-1 decision. The majority opinion held that Opinion No. 639 contained adequate findings, based on substantial evidence, to support the Commission's departure from the two-tier or vintaging concept insofar as the renewal contracts are concerned.

> Opinion No. 639 findings did in fact include detailed discussion of national gas supply, area gas drilling and production activities, intrastate competition for new gas, the need for deep gas exploration, comparison with costs of supplemental gas, and changes in costs of finding and producting new gas supplies. A major fact finding, pointing

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[12] *See*, Appendix B.

> toward the failure of vintaging, was that the exploratory gas well count in the area had been 97 wells in 1968 and that within one year after the issuance of Order No. 411 in 1970, applying the vintaging concept to the area, the exploratory gas well count dropped to 47 wells.[13]

The dissenting opinion found a lack of substantial evidence in Opinion No. 639 to support the orders here. The dissent regarded as crucial the absence of evidence in Opinion No. 639 supplying a nexus between the application of the new gas price to renewal contracts and the Commission's goal of using price as an incentive for improved gas supply. The contrasting views of the majority and dissent are illustrated in the following excerpt from the dissenting opinion.

> Under the plan projected by Opinion No. 639, the "new" price is not restricted to gas produced from new wells developed in that field; rather, all gas from the field would command the "new" price, including gas discovered, developed and dedicated long ago. Like the Fifth Circuit, the most I can say is that it is merely "conceivable" that the expectations of Opinion No. 639 will become a reality; like my colleagues, I cannot say with any degree of assurance that it actually will. In this milieu, there is, at least for me, a call for evidence resolving affirmatively the critical question whether the Commission's policy of pricing "old" gas at the "new" rate is promising enough as an incentive to survive the test of reasonableness. (footnotes omitted)[14]

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[13] Appendix A, p. 7.

[14] Appendix A, p. 18 (Dissenting Opinion).

REASON FOR GRANTING THE WRIT

1. The orders now before this Court signal a significant shift in the direction of F.P.C. rate regulation of gas producers. If allowed to stand, the policy reflected in these orders will in time erase the two-tiered structure of rate regulation which the Commission has consistently applied since the inauguration of group ratemaking for gas producers.[15] Commencing with the Commission's 1965 *Permian* decision,[16] the adoption of separate prices for new and flowing gas was seen as a reasonable device by which to balance the interests of consumer protection against excessive prices, on the one hand, and the need for a price high enough to provide the incentive for finding more expensive gas supplies on a current and prospective basis.

The two-tier structure was affirmed by this Court "on the basis of substantial evidence that a two-price rate structure will both provide a useful incentive to exploration and prevent excessive profits."[17] The Court specifically approved the Commission's reasoning

> "that excessive producer profit could be minimized only if the rate for flowing gas were derived from the most precise available evidence of actual historical costs."[18]

It recognized that the price fixed for "old" gas was relatively low "since price could not serve as an incentive, and since any price above average historical costs, plus an appropriate return, would merely confer windfalls."[19] Following its

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[15] *See*, Opinion No. 639, 48 FPC at 1310.

[16] *Permian Basin Area Rate Case, supra*, note 5.

[17] *Id*, at 798.

[18] *Id*, at 802.

[19] *Id*, at 797.

adoption in *Permian* in 1965, the Commission consistently employed the two-tier system in each of the other area rate proceedings which comprised its overall producer regulatory system.[20]

Nothing in the orders here demonstrates the need to abandon the two-tier system insofar as the instant sales are concerned. The application of the higher, new gas price to the Mobil and Continental contracts was not predicated on any evidence or findings that, as a result of the rate increase, further drilling would be undertaken or additional gas reserves dedicated.[21] Nor did these producers claim that the perviously-applicable flowing gas price was less than compensatory for the service rendered. The only discernible effect of the Commission's orders is that higher prices were received by the producers. The sole justification given by the Commission for allowing these rate increases was its Opinion No. 639 determination to interpret literally the vintaging provisions contained in area rate orders.[22]

Opinion No. 639 furnishes neither a legal nor factual basis for modifying the pre-existing two-tier rate structure applicable to the instant sales. On its face, Opinion No. 639 is a Commission ruling on issues raised with respect to rates in the Appalachian and Illinois Basin Areas. The proceeding which led to Opinion No. 639 was initiated by a public notice advising, *inter alia*, that the F.P.C. would consider such revisions of Sections 154.107, 154.108 [the pre-existing rate orders for the Appalachian and Illinois Basin Area]" . . . as may be found to be in the public interest." On the merits, the F.P.C. in Opinion No. 639 denied the rate relief requested by various parties with respect to sales made from the Appalachian and Illinois Basin Area. The Commission then

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[20] *See*, case cited at pp. 8-9, Appendix A (Dissenting Opinion).

[21] *See*, Appendix B.

[22] *Ibid.*

turned to the question of "price vintaging"—a phrase denoting the two-tier rate structure and a subject not mentioned in its notice or in any comments. In this gratuitous discussion, the F.P.C. stated that vintaging would be eliminated in all production areas by permitting the seller to charge the higher new gas price whenever a new contract was executed after the new gas division date and after expiration of the old contract.[23] This policy, the F.P.C. indicated, would be carried out "by interpretation of the specific language used in setting vintage rates.[24] Thus, the F.P.C. seized on the fact that the distinction between flowing gas and new gas had fortuitously been made on the basis of *contract date* rather than *service commencement date* as a device by which to abandon the two-tier system without following the procedures necessary to modify rates previously determined to be just and reasonable, i.e., those required by Section 5 of the Natural Gas Act.[25]

Despite its ingenuity, the F.P.C.'s literal interpretation theory is legally unsound. A literal interpretation of a provision which is inconsistent with its purpose must be avoided whenever the language can be construed consistent with its purpose.[26] The purpose of the two-tier price system is to provide an incentive to exploration while at the same time preventing excess producer profits on older, low cost service.[27] The F.P.C.'s literal interpretation, as applied in these cases, yields a price for old or flowing gas which is well

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[23] 48 FPC at 1309.

[24] 48 FPC at 1310. The two-tier structure created in the several area rate orders defined the applicability of the separate prices for flowing gas and new gas in terms of *contract* date rather than date of initiation of service. The choice of the contract date as the basis for the purpose of facilitating subsequent rate changes. *See, Texas Gulf Coast Area Rate Proceeding,* 45 FPC 674, 713(1971), *aff'd. on remand sub nom. Public Service Comm'n v. FPC,* 516 F.2d 746 (D.C. Cir. 1975).

[25] *See,* Appendix C.

[26] *See, Haggar v. Helvering,* 308 U.S. 389, 394 (1940); *Ozawa v. U.S.,* 260 U.S. 178, 194 (1922).

[27] *Permian Basin Area Rate Cases, supra,* at 798.

above the average-historical-cost-plus-return basis on which the flowing gas price was fixed. The orders below thus distort the purpose of the two-tier system and confer a classic windfall on the producers. What the F.P.C. termed an interpretation of its earlier rate orders was, in truth, a major revision thereof. Unquestionably, the F.P.C. had no legal power in its *Appalachian and Illinois Basin Area Rate Order* (Opinion No. 639) to revise the just and reasonable rate structure prescribed in other proceedings for the Texas Gulf Coast and Other Southwest Areas.

Nor did the Commission supply any factual predicate in Opinion No. 639 which would rationalize its orders in these cases. Its factual explanation was limited to the following statement:

> Vintaging operates to discourage development of the full productive capacity of acreage committed to the interstate market, for even though such developmental drilling is undertaken at current costs, gas production obtained thereby is priced at the *lower* of two rates, when it is the *higher* of the two that is Commission-designed to provide the incentive for development of additional gas supplies.[28]

Assuming this finding were valid,[29] it bears no relationship to the Mobil or Continental service covered by the instant orders. Neither producer claimed any intention to conduct developmental drilling in order to realize the full productive capacity of the fields in question. F.P.C.'s abandonment of

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[28] 48 FPC at 1309.

[29] No such assumption is justified. Both area rate orders covering the instant sales provided for escalations in the flowing gas price to reflect "increased drilling costs, well rehabilitation, equipment repair and replacement revenues from flowing gas as a source of funds for new investments," *Other Southwest Area Rate Proceeding*, 46 FPC at 900-918, N.23; *aff'd. sub nom. In re Other Southwest Area Rate Cases (Shell Oil Co. v.FPC)* 484 F.2d 469 (5th Cir. 1973), *cert. denied* 417 U.S. 973 (1974); *Texas Gulf Coast Area Rate Proceeding*. 45 FPC at 707-708.

the two-tier rate system is these cases should not be condoned by this Court. If major revisions in the ceiling rates applicable to older, flowing gas service are necessary, or if vintaging should be abolished, the Commission should be required to so find in a proceeding where those issues can be fully addressed by all parties. A policy so fundamental to the established scheme of producer regulation should not be undone through *post hoc*, "literal" interpretations.

2. The instant orders raise serious questions concerning the Commission's accountability to the nation's gas consumers in a period of acute gas shortage. In enacting the Natural Gas Act, it was

> "the intention of Congress that natural gas shall be sold in interstate commerce for resale for ultimate public consumption for domestic, commercial, industrial, or any other use at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest."[30]

The two themes of consumer protection from excessive rates and adequate gas service run throughout this Court's rulings involving F.P.C. rate orders.[31] Each of these principles is seriously prejudiced by the orders here.

The relationship of these orders to the issue of consumer rate protection has to do first, with the *quantum of justification* given for these rate increases. The F.P.C.'s apparent purpose in Opinion No. 639 was to provide natural gas producers with additional funds to finance development drilling for the benefit of the interstate market.

This is plainly a legitimate ratemaking *purpose* in this

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[30] *Atlantic Refining Co. v. Public Service Comm'n*, 360 U.S. 378, 388 (1959).

[31] *See, FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

time of nationwide gas shortage. But this purpose is not reflected in what the Commission has done here. Neither in Opinion No. 639 nor in the orders at bar did the Commission require any showing that the revenues derived from the producers' rate increases would be devoted to gas supply-enhancing activity. The *justification* for these rate increases is simply the execution of a new contract upon the expiration of the old. Whether the producers (whose primary product is *oil*) will choose to use these revenues for additional gas development is the problem. Certainly it is reasonable to expect that Mobil and Continental will elect to invest these revenues in activities other than gas exploration where their profits are not regulated.

The majority opinion in the court below upheld the F.P.C. because "it is not illogical to believe" that additional gas revenues will lead to an increased supply.[32] Such an approach to the Commission's ratemaking power is at war with the consumer protection purpose of the Natural Gas Act. The mere fact that additional revenues are thereby conferred on gas (and oil) producers in a time of gas shortage does not establish the justness and reasonableness of an F.P.C. rate order. An increase of *any* amount would qualify under such standard.

The precedent value of these cases is also pertinent to the issue of F.P.C. accountability to the gas consumer. The orders before the Court are representative of a group of not less than 52 such rate orders entered by the F.P.C. in reliance on Opinion No. 639.[33] These 52 rate orders cover a total of 224 separate renewal contract filings made by gas producers, i.e., many of the orders are "omnibus" rulings granting increases on a series of contracts. No computation has been

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[32] Appendix A, p. 10.

[33] AGD has intervened in those 52 separate FPC rate proceedings based on Opinion No. 639 in which the rate increases affected pipelines serving the eastern seaboard. Other cases involving increases to other pipelines have been processed but no count has been made.

made of the cumulative dollar impact of these increases. Nonetheless, it is safe to assume that the impact runs into the millions *and is still accumulating.* Moreover, the policy first adopted in Opinion No. 639 has been carried over in subsequent F.P.C. orders (now pending before this Court on writs of certiorari) revising the new gas ceiling prices.[34] These orders magnify the dollar impact of the Opinion No. 639 policy. Whereas Opinion No. 639 purported to authorize increases in the range of 4 to 15 cents per Mcf (depending on the applicable area price and the rate level previously collected), F.P.C. Opinion No. 699-H allows escalations in the range of 30 cents per Mcf.

Finally, the gas supply consequences of the instant orders and Opinion No. 639 are adverse insofar as the consumer is concerned. In response to the gas supply crisis, the F.P.C. has issued various rate orders in recent years which approve arrangements allowing producers to retain or earn revenues above the otherwise applicable just and reasonable ceiling in return for a commitment by the producer to explore for and/or sell additional gas to the interstate market. In the *Southern Louisiana Area Rate Cases,*[35] producers were allowed to "work off" some $150 million in excess charges by dedicating new gas reserves to the interstate market. In the same case, producers were allowed to earn flowing gas rate increases by dedicating additional gas reserves to the interstate market.[36] More recently, the F.P.C. has allowed pipeline-producers to increase rates charged their customers for company-produced gas in return for a commitment by the company to use the added revenue for gas exploration.[37]

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[34] *See, Shell Oil Company v. FPC,* 520 F2d 1061 (5th Cir. 1975). AGD's Petition for Certiorari of this ruling is pending at No. 75-1308.

[35] 46 FPC 86, 147-148 (1971), *aff'd. sub nom. Mobil Oil Corporation v. FPC* 417, U.S. 283 (1974).

[36] *Id,* at 143.

[37] *Panhandle Eastern Pipe Line Company,* Opn. No. 626, 48 FPC 518 (1972).

Further, in the *Tennessee Bastian Bay* case[38] the Commission allowed certain producers to retain revenues relating to past excessive charges on condition that a specific volume of new gas reserves be dedicated to the Tennessee pipeline system within a specified period. In Opinion No. 639 and in the instant orders, the F.P.C. inexpliciably ignored the opportunity to fashion a similar gas supply *quid pro quo* remedy. If the F.P.C. were to use the millions of dollars of revenues involved here as leverage to induce additional interstate gas sales, the supply impact could be truly significant. The failure to do so leaves the consumer interest unprotected both in terms of adequate gas service and excessive, unjustified rates.

CONCLUSION

For the reasons set forth above the Court should grant the petition for certiorari to review the judgment and opinion of the U. S. Court of Appeals for the District of Columbia Circuit.

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[38] *Tennessee Gas Peipline Company, a Division of Tenneco Inc., et al.*, Opinion No. 667, 50 FPC 1194 (1973).